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Remarks of
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Federal Energy Regulatory Commission

"Not Your Father's Energy Crisis"

Governors' Natural Gas Summit
Responding to the Looming Energy Crisis
Columbus, Ohio

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Governor Knowles, Governor Taft, Ladies and Gentlemen:

I wish to express my appreciation to Governor Knowles and Governor Taft for inviting a regulatory perspective on this critical matter of energy costs. As always, Christine Hansen of the IOGCC has been of great assistance to me.

This meeting is very timely and American energy consumers are well-served by a frank appraisal of the current economic issues that affect their livelihood and

their life styles. We need public officials like these two Governors to help the public understand the importance of energy -- how and where we need to get it, what it costs, and how we should use it.

Today's discussion thus far confirms that consumers can expect higher natural gas prices this coming winter, and that these prices will also reverberate in the price of electricity in many locales. Consequently, there is renewed anticipation in the media that these high energy prices signal a returning "energy crisis" not unlike the one that challenged our Nation's prosperity and security in the early 1970s.

I have reflected on this proposition in light of my experience as a federal regulator and the escalating prices in the real-time and forward markets for natural gas. It does not surprise me that some observers have jumped to the conclusion that the problem can be traced to market fundamentals, or even artificial scarcities or

collusion. The rate shocks which hit electric consumers hard in the wallet this summer might seem to confirm that view. And, indeed, I would concede that the restructuring of the electric power business still has a great distance to travel to achieve real competitive markets. Absolutely no one is more impatient than me to get the job done.

However, I want to emphasize today that the midstream natural gas market -- that is to say, the integrated network of interstate pipelines which brought the benefits of wellhead decontrol to the city-gate and beyond -- is both dynamic and fundamentally sound. I think the pipeline grid supports the best, most transparent, and liquid interstate energy commodity market. And this sophisticated and adaptable interstate gas market will be critical to solving the electric generation supply shortfalls that currently plague whole regions of the country. In other words, the framework exists within the structure of the natural gas delivery

system and the system of regulations that govern it, that will allow us to work through this difficult period and come out with very positive market solutions on the other end.

So, if indeed we have an energy crisis on our hands, it is not your father's energy crisis.

What do I mean by that specifically? To be sure, consumers are entitled to be concerned. High energy prices can cause a feeling of economic vulnerability at a minimum or, at the other extreme, real hardship. Moreover, we live in transformative and thus uncertain times. The Nation's infrastructure is changing in fundamental ways. The demand for energy has escalated as the economy has sustained its growth, while the supply response has lagged. Uncertainty, whether caused by economics or public policy, can be the death of investment. I don't see a dangerous level of uncertainty in today's natural gas markets with respect

to fundamental issues of adequate reserves or an ability, ultimately, to develop those supplies and get them to market.

You might recall that, in the 1970s, when we last had a major run-up in oil prices, at a time when oil and natural gas prices more closely tracked one another, natural gas suddenly became a hot commodity, except for one problem: we thought there was very little of it left in the ground. Our response to changed conditions was a command-and-control public policy response: we curtailed usage as a way to reallocate the resource; price regulation drove supplies from the interstate to the intrastate markets; new customers were fenced out; the boiler fuel uses of gas were prohibited. That was the old way of trying to redress a supply/demand imbalance. Every day, regulators decided who got to use this scarce commodity. Almost lost in the commodity price worries of the time was the balkanized state of monopoly

pipeline markets, which later became the focus of federal regulatory reforms.

Compared to that era of "crisis," ours seems far more manageable and less mysterious. The decontrol of natural gas prices during the 1980s led to a basic reinterpretation of the North American and global natural gas reserve base. To my knowledge, today's Canadian and Lower 48 gas reserves are sufficient for many decades of projected domestic consumption. Access to Alaskan supplies and offshore LNG further enhance the picture. Gas supply today is thought of primarily as a function of access and price, not as a geological rarity. Congress, as well as the Commission, have decided that production markets are competitive and have abandoned price regulation. But what is there to ensure that a change in the price of gas at the wellhead will elicit a demand response, or vice versa, half a continent away?

The FERC is 15 years into promoting an integrated pipeline grid nationally and, with it, a maturing commodity market. Pipeline sales and transportation functions have long since been unbundled and curbs have been placed on the holders of residual market power. Markets have evolved to recognize separate products. Hubs have emerged. Electronic media make pipeline capacity information widely available. Electronic trading of natural gas grew from 33 Bcf in 1994 to nearly 3 Tcf in 1998. Since Order No. 436 in 1985, operation of the grid on an open access basis has resulted in innovation, lower transaction costs, and the transmittal to end users of the benefits of decontrol in the form of lower prices. Competition and the historic gas "bubble" (which is obviously gone), produced substantial consumer savings. Retail prices declined by 42 percent in inflation-adjusted dollars between 1984 and 1997. If gas prices had remained at 1984 levels, consumers would have paid $50-$60 billion more for gas in 1995. Increased pipeline efficiency contributed to

the savings, too. The cost of the midstream market, measured as the difference between wellhead and citygate prices, declined in real terms nearly 23 percent between 1985 and 1997. We have a responsibility to try and replicate that performance. EIA projects another 14 present decline by 2020. Although we might be dismayed at the public's, What have you done for me lately?, the market has created an expectation of cheap energy. In other words, we have our work cut out for us.

As we confront the current supply and price dislocations, the midstream market is therefore in a far better position to relay appropriate price signals between the wellhead and the end user than it was two or three decades ago. The rapid response of gas producers, who doubled the domestic rig count in a very short time as prices moved above $3, demonstrates a functioning market. And if price differentials between wellhead and burnertip become greater, the market is likewise signaled that more pipeline capacity is required.

However, this strong economy comes with special challenges. Domestic energy consumption has increased 35 percent in the last decade and could grow as much as 60 percent by 2020. Use of natural gas has already surpassed historic high levels at about 22 Tcf annually. This year so far natural gas demand for electric generation has increased about 4 percent above 1999 levels and the National Petroleum Council (NPC) believes that electric generation will account for nearly 50 percent of demand growth between now and 2015. Electric generation could create as much as 7 Tcf of gas demand by itself during that period. In other words, a 30 or 35 Tcf natural gas market in the United States is no longer a pipe dream.

Although the North American gas delivery network is highly integrated, interoperable, and capable of serving these increased loads and doing so with a degree of flexibility, the question of the hour is, will it stay that way? Will additional pipeline be needed to serve

the new market and how much? And, does the current pipeline system represent an impediment to market recovery and stabilization of consumer prices? I think the answer to such questions should be reassuring, both to market participants and to consumers who would like to see prices moderate. It seems clear that the level of capacity additions necessary to accommodate new markets will vary regionally and they may shift to accommodate new supply locations in the deep water Gulf, the Rockies, and the Canadian Atlantic. The typical policy worries persist about the risk of excess capacity that could be a drag on the market, the need for capacity surpluses to foster gas-on-gas competition, and the environmental and operational challenges to expansion of the pipeline infrastructure, both in frontier supply basins and crowded market areas. The question of "how much" is therefore not easily answered. However, when it considers whether a proposed facility is in the public interest, the FERC now uses a variety of tests to satisfy itself about the need for specific

pipeline expansions. I believe that the Commission's approach to certificating pipeline capacity additions represents a more systematic, transparent, and balanced implementation of its Natural Gas Act mandate than has been the case in the past.

Today there are 270,000 miles of gas transportation facilities and about 3.2 Tcf of working gas storage capacity. In 1997, the pipeline system could deliver up to 131 Bcf per day, about 20 Bcf/d above firm peak-day demand. Since 1997, the Commission has certificated approximately 6,000 miles or 17 Bcf/d of new pipeline capacity. Moreover, we have authorized these expansions responsibility, with knowledge of the environmental complications, which are mitigated in all cases. The NPC projects a need for 38,000 miles of added interstate pipeline in the coming years, a relatively modest and achievable rate of growth that compares favorably with rates of pipeline growth in the past decade.

As regulators, we are occasionally presented with proposals that break the mold or which portend major shifts in the midstream market. Recently, we have been hearing talk of a unique long-line project, or group of projects, which could help secure the supply picture for large portions of the Lower 48 states, at least at some point after 2007. After 20 years, renewed interest in access to the 35 Tcf of proven Alaskan natural gas reserves is about to revitalize the Alaska Natural Gas Transportation System (ANGTS), or some version thereof. I believe this could be among the most provocative responses to our "crisis," acknowledging Dan Yergin's warning about the inevitable lead time for such a project.

Plenty of history comes with this issue. In 1976, Congress enacted the Alaska Natural Gas Transportation Act (ANGTA) to establish a mechanism for the President to designate a natural gas pipeline route to deliver Alaska natural gas to the Lower 48 States.

ANGTA is still law, but much has changed since 1976. In light of these legacies, the Commission, Congress, and pipeline proponents must consider what the best solutions are for the Nation's energy needs today and whether some of the questions answered more or less definitively 20 years ago could have different answers today. I suspect that many of those answers remain the same, as today's discussion suggests.

While the Commission would expect to devote substantial resources to any proposal of this size and significance and to respond in a timely manner, reactivation of the ANGTS would also require us to address several novel issues about the meaning of the ANGTA and the President's Decision as part of the process. For example, can the original project be reconfigured and updated to account for improved technologies and still be considered under ANGTA? Can other projects be approved under the Natural Gas Act in addition to, and separately from, the project specified

in the President's Decision? Also, what flexibility do the sponsors, the President, or the Commission have to depart from the original ANGTS proposal? These issues suddenly require our immediate attention.

Although additional analysis will be important to an efficient regulatory approval process, we are always counseled not to study things to death. Today's market conditions make that admonition forcibly. In that connection, a Commission staff team is reviewing the history of the ANGTA proceedings and the applicability of previous decisions to, and effect on, new pipeline applications and proposals put forth under today's circumstances. They are looking at what aspects of the Commission's conditional certificate for ANGTS and related orders may need to be reconsidered in order to accommodate and process any applications that may be filed in the future. Staff's threshold findings and conclusions on these regulatory matters will be available early next year.

In sum, the Commission is willing and able to think strategically about the long-term needs of the market and gas consumers, work with pipeline applicants, and to use its authority creatively to ensure energy security for the Nation. Federal regulators are also ready to defer to market solutions, to the extent permitted by law, where the market is competitive and producing benefits for consumers. Generally speaking, I think the domestic gas market, at least up to the citygate, is structurally such a market.

I think our trust in the interstate market will be confirmed. If there is not a sufficient price response in due course, however, pressure to seek traditional regulatory solutions will inevitably mount. It will not matter then what anyone thinks the theoretical inadequacies of price caps might be. We must therefore be proactive in ensuring that markets continue producing benefits for consumers. That is a kind of regulation we all ought to be happy with. The fact that, as a Nation,

our energy goals, such as delivering sufficient natural gas to serve this growing digital economy, are clear and very achievable and that we have the tools to turn this gas price problem around in the near future makes me think that this is not your father's energy crisis.

Thank you.